Real Estate in 1956

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As I see

REAL ESTATE IN 1956

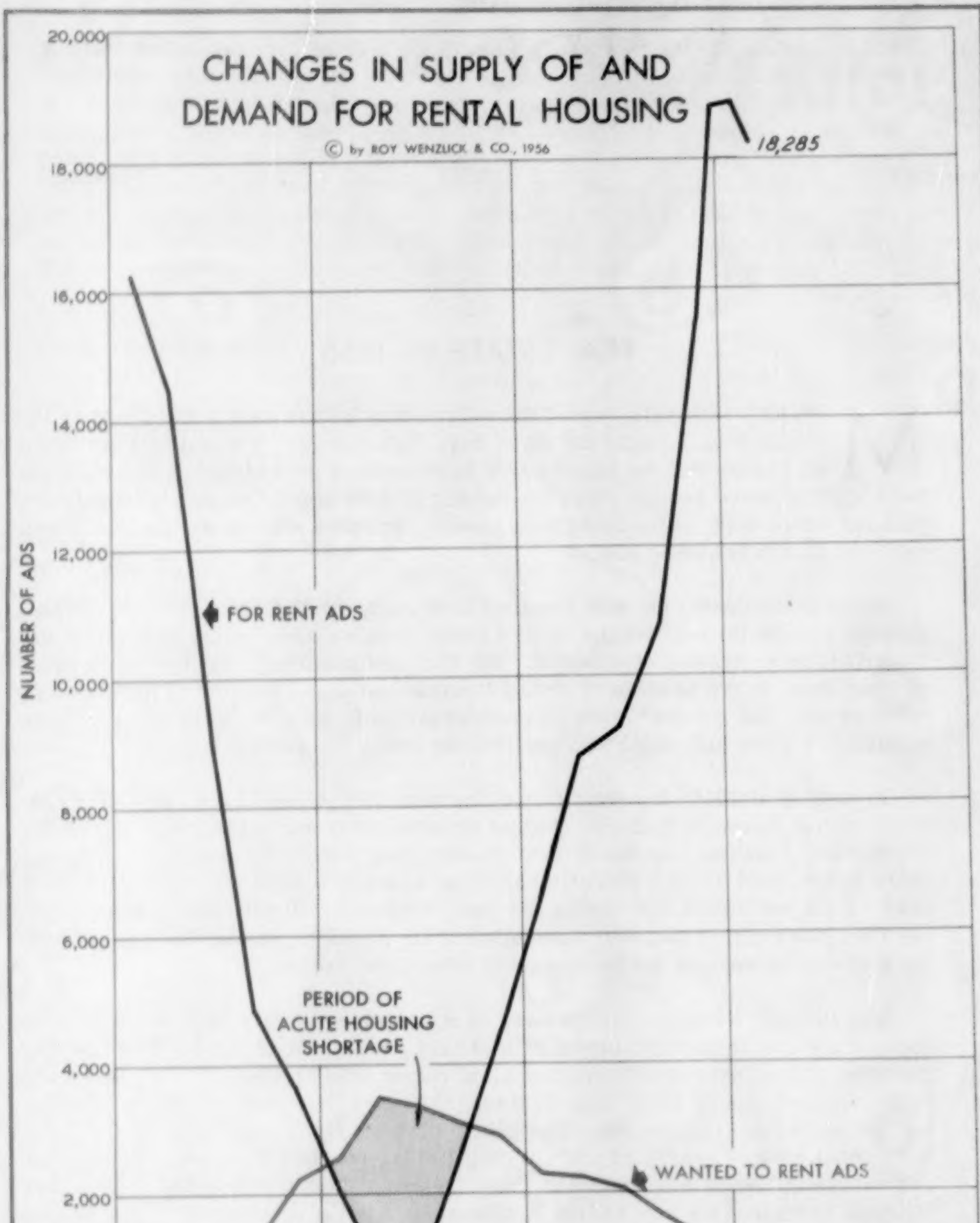
MURRAY SHIELDS, one of the outstanding business economists in the United States, said the other day: "Personally, I would feel far more certain that we would never have another depression if more people were apprehensive enough about the danger of it to oppose more vigorously the policies which will, if followed long enough, produce a boom so big that it can only end in a resounding bust."

Many times during the past 5 years I have made the statement in talking before various groups throughout the United States that we have plenty of tools in the United States to prevent depressions, but that, unfortunately, we have worn most of them down to the handles in trying to make our boom bigger. I have always believed that "hangovers" were an unnecessary affliction but were more or less inevitable for the individual who emptied the bottle the evening before.

In looking at 1956, it seems to me that this will be one of the rather critical years in our economic history. Judged by most economic measures - industrial production, consumer incomes, new construction, railroad tonnage, department store sales, and other generally relied on indexes - 1956 will be a very good year. I am not afraid that during the year our boom will turn into a depression but I am more afraid that overstimulation of the economy may lay the groundwork for some more serious readjustments in subsequent years.

The Federal Reserve System has, in my opinion, rightly applied the brakes some time ago to an economy that was fast getting out of hand. The housing agencies of the Government, spurred on to rather wild excesses in easy financing by the Housing Act of 1954, also tightened the reins, reduced the length of loans and increased downpayments. The public clamor which resulted, particularly in the real estate, mortgage and building fields, reached sufficient proportions and enough influence was applied to Congressmen and other influential Washington officials to weaken the stand of the Administration to the point where it now seems certain that credit will again be quite easy in the relatively near future for new building and for the financing of existing properties.

Real Estate Economists, Appraisers and Counselors

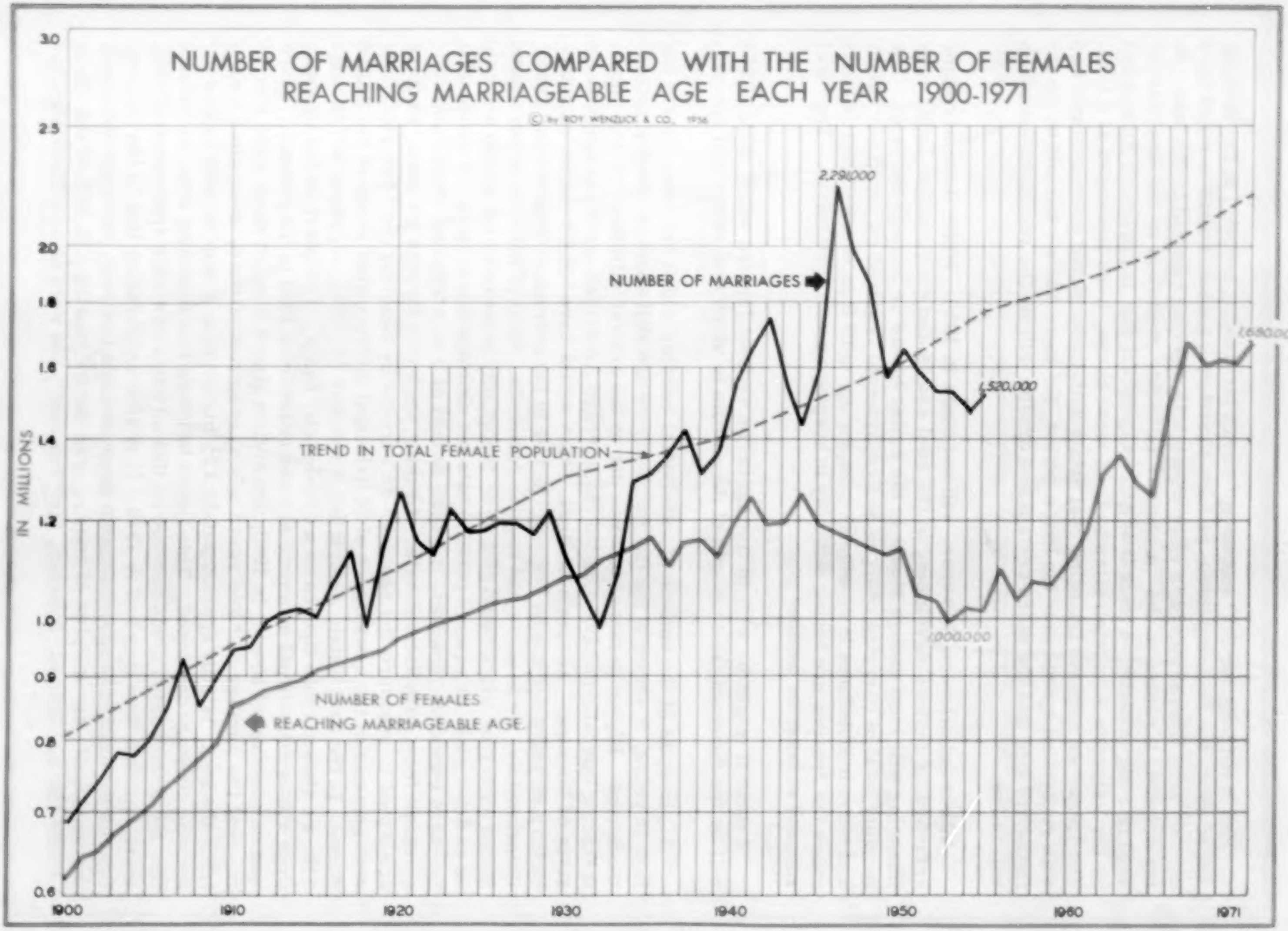

CHANGES IN SUPPLY OF AND
DEMAND FOR RENTAL HOUSING
© by ROY WENZLICK & CO., 1956
18,285
FOR RENT ADS
PERIOD OF
ACUTE HOUSING
SHORTAGE
WANTED TO RENT ADS
796
NUMBER OF ADS
20,000
18,000
16,000
14,000
12,000
10,000
8,000
6,000
4,000
2,000
0
1940
1945
1950
1955
1960

Had it not been for the "souped-up" credit for housing provided in the Housing Act of 1954, the financing terms we have seen during the last 6 months would have seemed very liberal indeed in comparison with any other period in the past. In my opinion, a return to the "madman" financing prevalent in the first part of 1955 is a big mistake. I think it is quite significant that the property foreclosed by the Veterans Administration has, in most cases, been liquidated at a loss. The longer we continue financing real estate with insignificant downpayments and with repayment spread over too long a period, the more fuel we will add to the inflationary fire and the more certain and drastic will be the readjustment which will follow.

This readjustment, however, will not come in 1956. While there are many unfavorable factors developing in the real estate and construction field, easy financing will keep enough steam in the boiler to see us through the year. The monthly total of carrying charges and repayments required on consumer credit and other indebtedness is constantly creeping up, until it is rumored that in many cases the Joneses are having difficulty in keeping up with themselves. They will succeed at least for another year.

I think it might be well to list again the various factors which during 1956 will be the dominant determinants of the climate in which real estate will operate.

1. In spite of the volume of residential building which has been done in the last 10 years, it seems to me that nationally we are still short on housing accommodations. Higher personal incomes due to the greater efficiency of our manufacturing operations have enabled the average American family to upgrade its style of housing. Accommodations which would have been considered satisfactory 20 years ago are no longer attractive to the average middle-income group. Unfortunately, we have not had regular residential vacancy surveys in the United States each year which would give us an opportunity to measure the trends and help us to determine our present position between shortage and surplus. A successful business executive, however, has been defined as a man who can reach valid conclusions from insufficient data. Lacking the basic figures we need, we have attempted to measure the shortage or surplus by counting the "For rent" advertisements in the newspapers of 50 principal metropolitan areas of the United States. In the Real Estate Analyst for November 25, 1955, on pages 507 through 512, we showed these figures on a city-by-city basis. The chart on the opposite page shows the national summary of these cities from 1940 to the present. There was no shortage of housing in 1940, and at first glance it might seem quite alarming that the number of "For rent" ads at the present time, even after a drop from the high, is still approximately 12% higher than it was in 1940 before the housing shortage developed. This figure becomes less alarming when we realize that the metropolitan areas covered by this ad count now have approximately 60% more families than they had in 1940. It is also encouraging that in the national figures the number of advertisements decreased this last year, certainly indicating that nationally any surplus of housing was not increasing. In 44% of the cities covered by our figures, however, the "For rent" ads were at an alltime high, or


NUMBER OF MARRIAGES COMPARED WITH THE NUMBER OF FEMALES
REACHING MARRIAGEABLE AGE EACH YEAR 1900-1971
© by ROY WENZLICK & CO., 1956
IN MILLIONS
3.0
2.5
2.0
1.8
1.6
1.4
1.2
1.0
0.9
0.8
0.7
0.6
1900
1910
1920
1930
1940
1950
1960
1971
2,291,000
NUMBER OF MARRIAGES
1,520,000
1,680,000
TREND IN TOTAL FEMALE POPULATION
1,000,000
NUMBER OF FEMALES
REACHING MARRIAGEABLE AGE

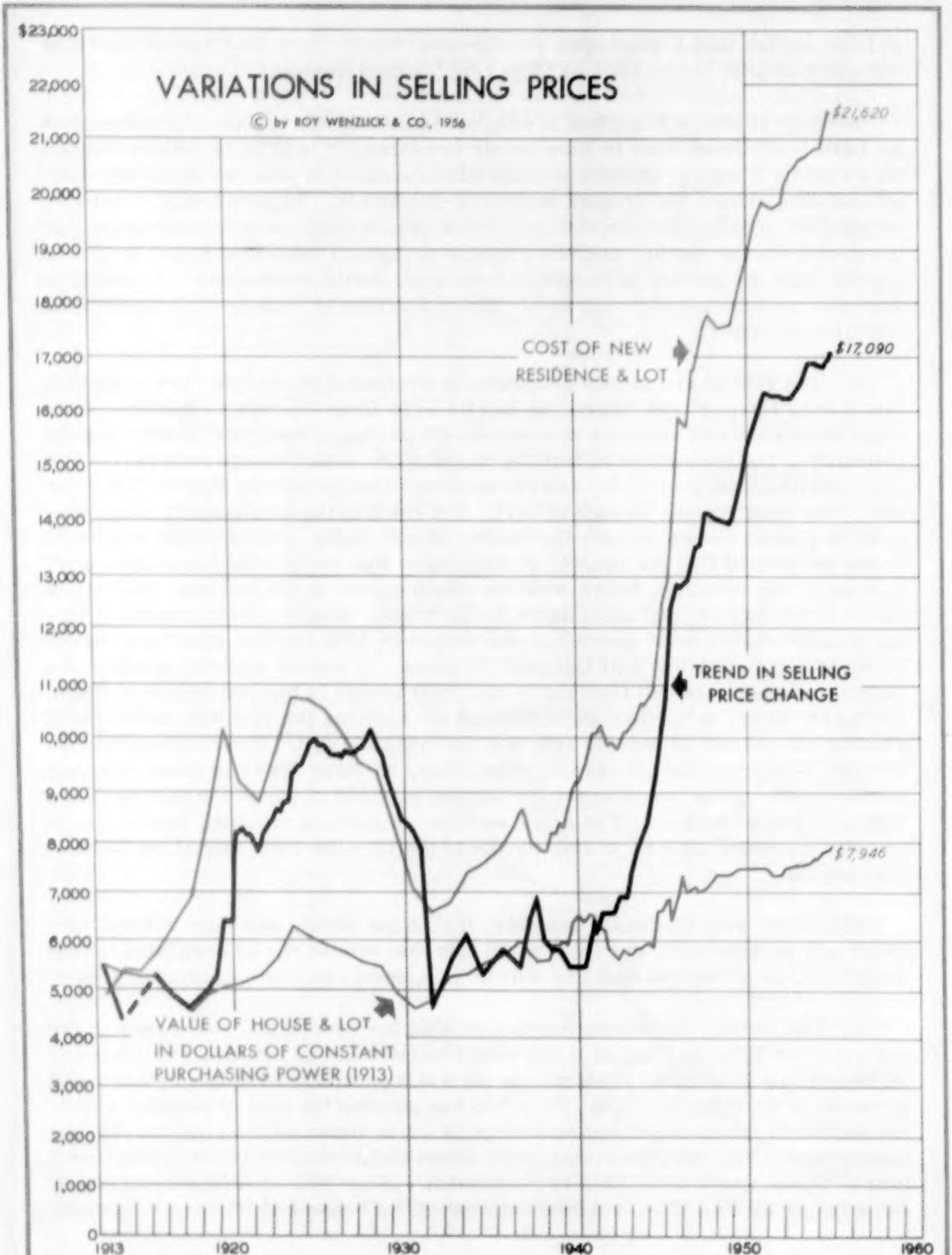
at least higher than a year ago. On the other hand, more than half of the cities showed a drop in the number of "For rent" advertisements.

While it is always hazardous to estimate immeasurable factors, various studies we have made from time to time in our organization lead us to believe that we may still be 2 million housing accommodations short of what we would consider an adequate supply for present economic conditions. Unfortunately, however, demand for housing accommodations varies greatly with the economic cycle. In boom periods the number of square feet of occupied residential space is always greater than the number of square feet occupied during recessions. A change in business conditions could very easily turn a shortage of housing accommodations into an oversupply.

2. The rate of new family formation in the United States has been relatively low during the past few years, as can be seen from the chart opposite. This chart shows the total number of marriages each year, the trend in total female population, and the number of females reaching marriageable age each year. The chart starts in the year 1900, and the marriage line runs from 1900 to 1955, the other two lines running through to 1971. The trend in the total number of females acts as a rough normal line for the number of marriages, and from that standpoint it will be noticed that the number of marriages was above what we would expect it to be in the twenties, below what we would expect in the thirties, very much above in the forties, and again below in the fifties. In spite of our rapidly growing population, the total number of marriages in 1955 was the smallest number we have had in any but 2 of the past 16 years. It seems doubtful whether the number of marriages will increase by any great amount in the next couple of years, and this belief is further strengthened by studying the red line on the chart showing the number of females reaching marriageable age. This chart shows that in spite of our rapidly increasing population, we have fewer persons reaching marriageable age at the present time than we have had in any of the past 30 years with only one exception. The small number of persons reaching marriageable age at the present time is, of course, due to the very low birth rate of the depression period.

This chart would indicate, however, that in the middle and later sixties, demand will be increasing at a more rapid rate than houses can be completed. This would lead us to believe that this will be a period of an acute housing shortage.

3. The excess credit which was available for residential real estate in the early part of 1955, coming as it did when commercial and industrial building and highway and public utility construction were at a peak, resulted in a rather rapid increase in construction costs. How this has affected the cost of building a typical six-room frame residence on a suitable lot is shown on the chart on the following page. The red line on this chart shows the fluctuation in the replacement cost of this property from 1913 to the present. Since May, the construction cost has gone up by 4%. The replacement cost of the house and lot is now approxi-


VARIATIONS IN SELLING PRICES
© by ROY WENZLICK & CO., 1956
$23,000
22,000
21,000
20,000
19,000
18,000
17,000
16,000
15,000
14,000
13,000
12,000
11,000
10,000
9,000
8,000
7,000
6,000
5,000
4,000
3,000
2,000
1,000
0
1913
1920
1930
1940
1950
1960
$21,620
COST OF NEW RESIDENCE & LOT
$17,090
TREND IN SELLING PRICE CHANGE
$7,946
VALUE OF HOUSE & LOT IN DOLLARS OF CONSTANT PURCHASING POWER (1913)

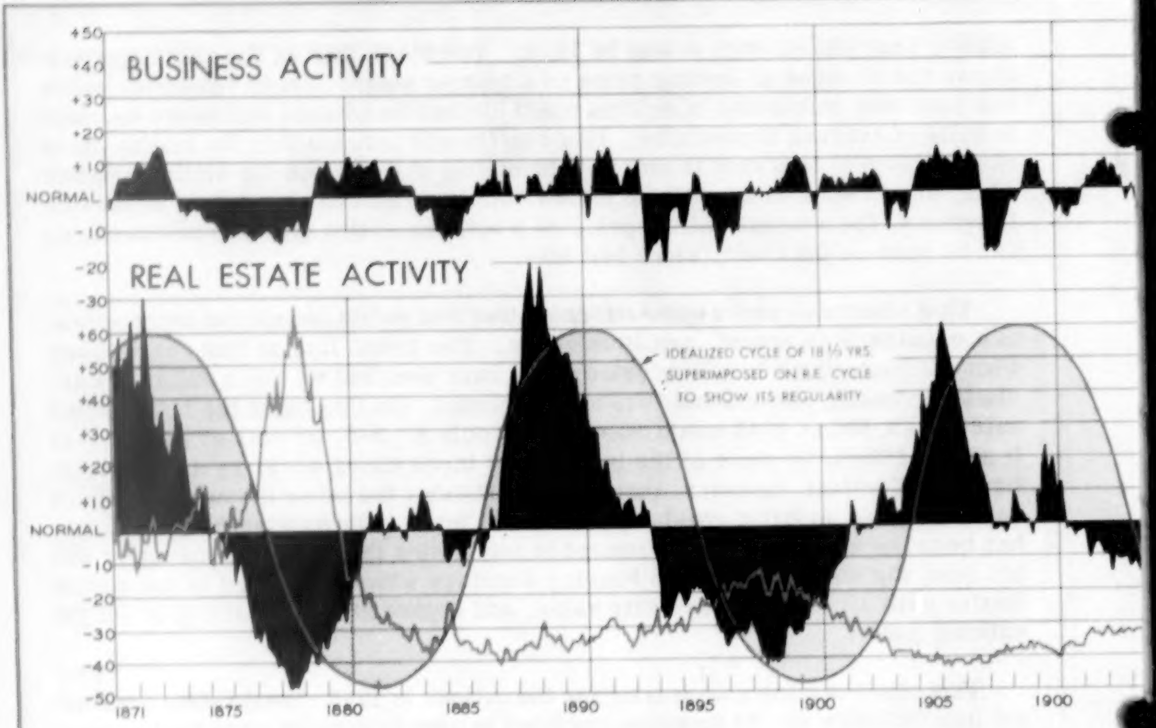
mately four times what it was in 1913. The black line on the chart opposite shows the changes in selling price of a typical single-family residence which has been well maintained in an area which has had no adverse influences develop. In spite of accrued depreciation, this chart would indicate that the selling price of a building of this sort is now approximately three times the selling price in 1913, and in spite of the volume of new building which has been done in the last few years, the average selling price on a building of this type has advanced, as can be seen on the chart, since last May.

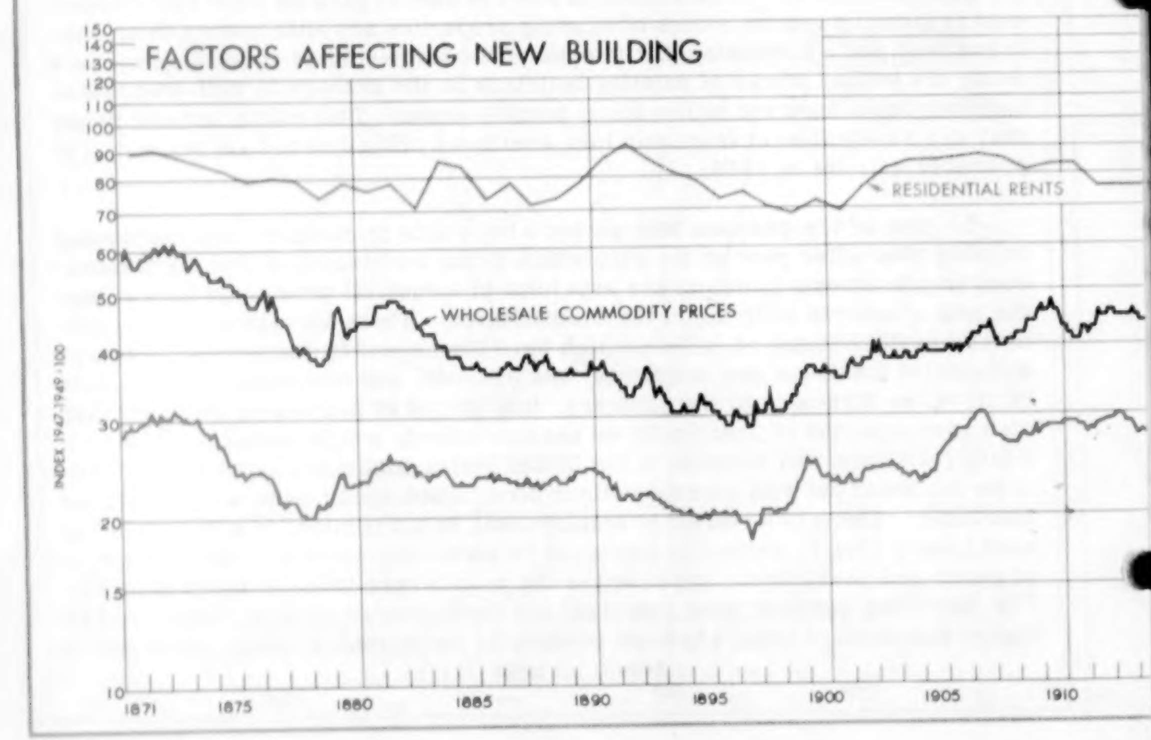
This chart also shows quite strikingly that real estate booms and depressions, to a considerable extent, are illusionary. The green line on this chart shows what the fluctuations in selling price would have been had we had a dollar of constant purchasing power from 1913 to the present. On this basis the house which sold for $5, 500 in 1913 would now sell for only $7, 946, or only 45% more than it sold for then, in place of the increase of three times shown by actual dollar figures. The fact, however, that this line showing the price in constant dollars has been going up fairly regularly since 1944 would indicate that though inflation has been the most important element in increasing the price of housing, it has not been the sole cause. The housing shortage which developed in the middle forties gave all housing a scarcity value, and apparently that scarcity is not yet entirely gone.

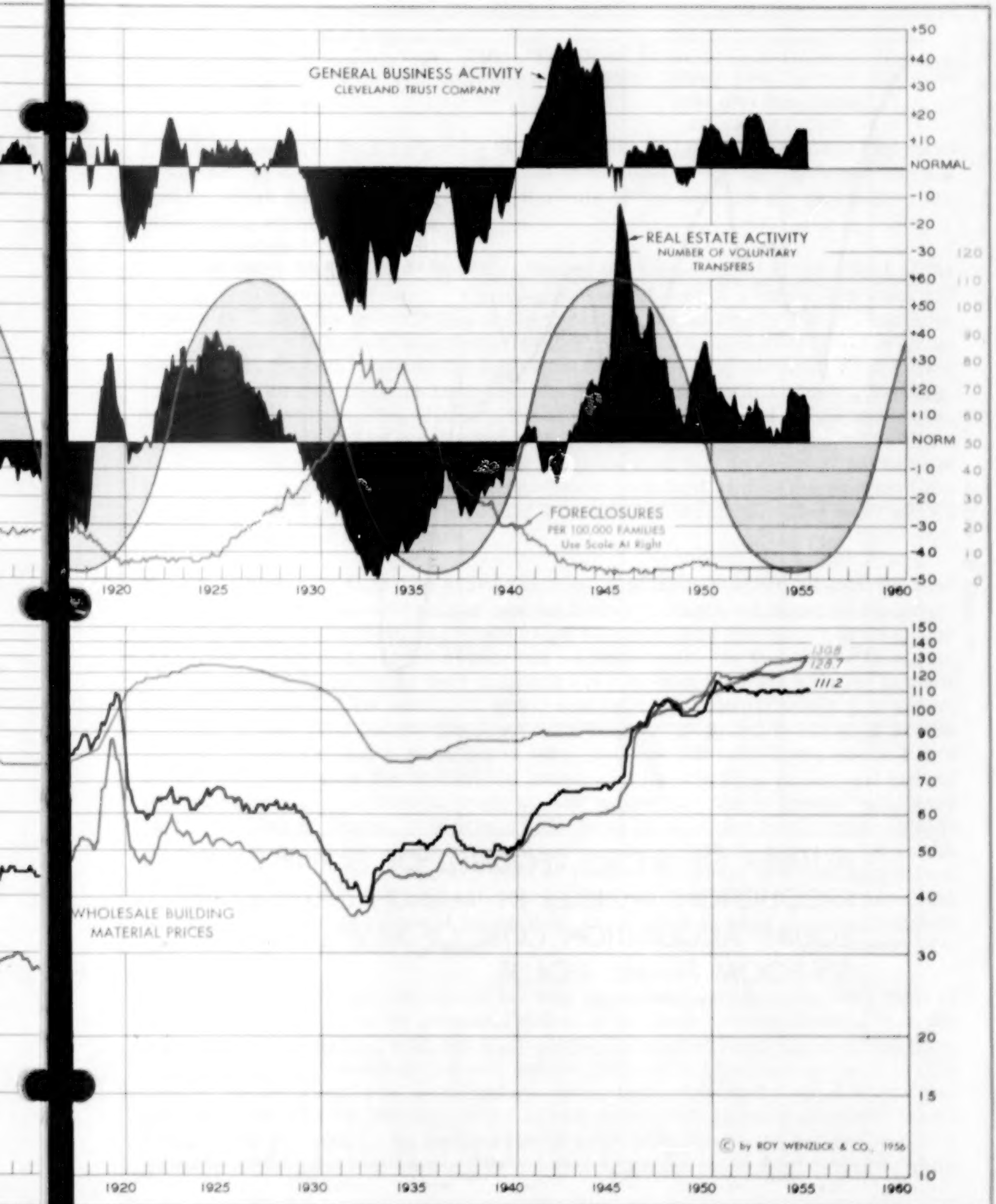
This chart is quite encouraging for the outlook in 1956. Real estate does not get into difficulty nor do foreclosures start to rise in periods when replacement cost is going up and the values of existing properties are still holding their own. It has been quite surprising that in spite of the large volume of building we have done, the selling prices of existing buildings on the average in well-maintained neighborhoods have not shown fairly sizable drops. This would indicate to me that any readjustment from our long continued boom has not yet started, and probably will not in 1956.

4. One of the reasons why we have been able to continue new residential building year after year at the rate which it has maintained is that the tremendous improvements in output per man hour in industrial production have raised the real standards of living in the United States. These increases are due primarily to the billions of dollars which have been spent by industry on research and involve the use of new materials, new methods, and new equipment. In spite of all of the forecasts to the contrary, this period of increasing efficiency has also been a period of practically no unemployment, and it certainly looks as if a labor shortage will continue in the United States during the foreseeable future if we can avoid the wild excesses of our boom which would make a readjustment inevitable. There is no threat to employment, in my opinion, in automation, as each time a routine worker is displaced by electronic controls, the total output of goods and services is increased to the point where there is more to divide. The displaced workers from this field are badly needed in other fields, and as higher standards of living are made possible by the increased output, the demands

(cont. on page 11)


BUSINESS ACTIVITY
REAL ESTATE ACTIVITY
IDEALIZED CYCLE OF 18 1/3 YRS. SUPERIMPOSED ON R.E. CYCLE TO SHOW ITS REGULARITY
NORMAL
1871
1875
1880
1885
1890
1895
1900
1905


FACTORS AFFECTING NEW BUILDING
RESIDENTIAL RENTS
WHOLESALE COMMODITY PRICES
INDEX 1947-1949 = 100
1871
1875
1880
1885
1890
1895
1900
1905
1910


GENERAL BUSINESS ACTIVITY
CLEVELAND TRUST COMPANY
REAL ESTATE ACTIVITY
NUMBER OF VOLUNTARY TRANSFERS
FORECLOSURES
PER 100,000 FAMILIES
Use Scale At Right
NORMAL
NORM
WHOLESALE BUILDING
MATERIAL PRICES
130.8
128.7
111.2
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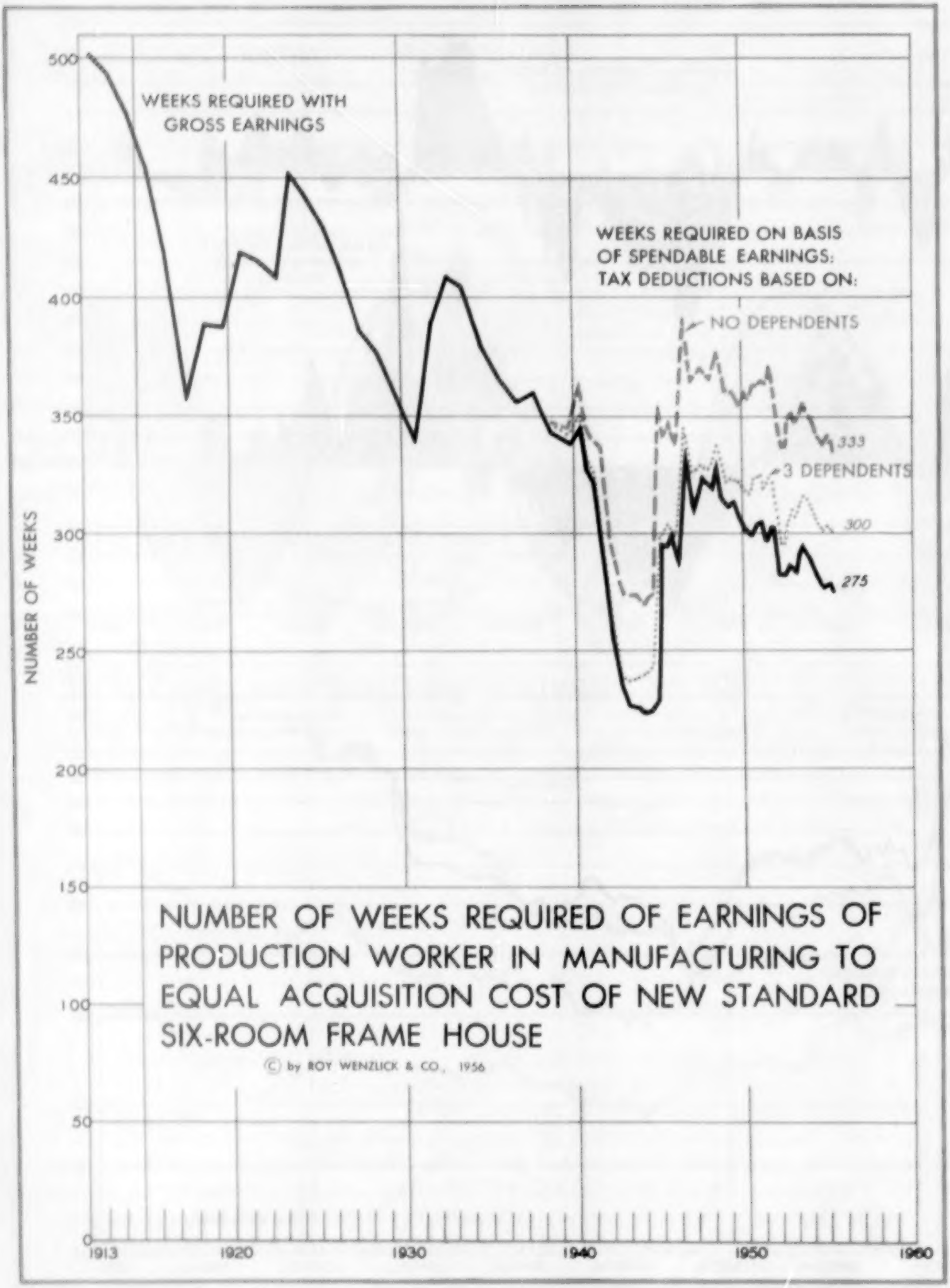

WEEKS REQUIRED WITH GROSS EARNINGS
WEEKS REQUIRED ON BASIS OF SPENDABLE EARNINGS: TAX DEDUCTIONS BASED ON:
NO DEPENDENTS
3 DEPENDENTS
333
300
275
NUMBER OF WEEKS
500
450
400
350
300
250
200
150
100
50
0
1913
1920
1930
1940
1950
1960
NUMBER OF WEEKS REQUIRED OF EARNINGS OF PRODUCTION WORKER IN MANUFACTURING TO EQUAL ACQUISITION COST OF NEW STANDARD SIX-ROOM FRAME HOUSE
© by ROY WENZLICK & CO., 1956

(cont. from page 7)
for goods and services will increase still faster, taxing even the new levels of industrial production.

The number of wage earners in the $4,000-$10,000 income group has increased twice as rapidly as the total population in the United States. It is this income group which has always furnished the bulk of the demand for new and better housing.

The chart on the page opposite gives some visual proof of the effect of the higher real earnings of labor. This chart shows the cost of a typical new standard six-room frame house expressed in the number of weeks required of the earnings of production workers in manufacturing to equal the acquisition cost of the house and lot. In 1913, it required the equivalent of 502 weeks of earnings to equal the cost of the house. This is equivalent to the full earnings for almost 10 years, and was a heavier housing load than the average family could afford to undertake, particularly with the interest rates which were current at the time. The chart indicates that while there have been variations up and down from 1913 to the present, the general trend has been markedly downward, and at the present time the same house could be purchased for 275 weeks of earnings. This has reduced the 10-year period to 5.3 years.

Of course, this figure on gross earnings is of more theoretical interest than it is of practical interest because now the Federal income tax deprives the average worker of a considerable portion of his earnings, and this money is no longer available for housing. If the worker has no dependents, his income tax is higher and, accordingly, he would have to devote his take-home pay for a larger number of weeks to pay for his house. It would now take him approximately 6.5 years, but this is still a big improvement over the 10 years required in 1913. If he has three dependents, his income tax is less, and now his take-home pay in 5-3/4 years will amount to the cost of his house. While this drop in the real cost of the house in earnings to the average worker is partially due to greater efficiency in the building of houses, it is primarily because of increases in efficiency outside of the building trades. This can be proved quite simply by showing, as we did in the chart on page 6, that the cost of housing in terms of a constant dollar has been increasing. If the efficiency in the building field had kept pace with the efficiency in other lines of production, the cost of housing in a constant dollar would have remained constant.

5. The center spread in this bulletin on pages 8 and 9 shows the cycles of real estate activity in the principal cities of the United States from 1871 to the present in comparison with the fluctuations in general business over the same period. Superimposed on the real estate cycle is an idealized cycle of 18-1/3 years. It can readily be seen that our cycle has gotten badly out of step. The big depression of the 1930's, insofar as real estate activity was concerned, lasted longer than any other real estate readjustment period we have had in the entire history of the United States. The present boom period in real estate activity

has now lasted about 2 years longer than the longest real estate boom period we have ever had in the history of the United States. The unusual length of the readjustment period of the thirties, of course, partially accounts for the unusual length of the present boom. Following a period in which little building was done for a long period of years, it would naturally take longer to make up the shortage. While this explains why our boom has lasted longer than the average, it does not give us any conclusive proof that this boom will not be followed by a readjustment as has always occurred in the past.

One other factor in regard to the real estate cycle seems to be significant, and that is that in the past the great bulk of commercial building has always been done toward the tail end of the booms. In the early part of each boom, most of the building construction was on residences, primarily single-family and duplex. In the last few years of the boom a very large portion of the building consisted of large apartment buildings, hotels, office buildings, and institutional buildings. At the present time we are again building office buildings and other large commercial buildings in great quantity, with each year surpassing the records of the preceding year by a very large percentage. While this is not necessarily an indication that the boom is nearing its end, it is certainly a warning which should make us proceed with some caution.

The foreclosure rate as shown on this chart is quite encouraging in that foreclosures are practically nonexistent. This does not mean, of course, that we have solved the problem of riskless investment, but it does mean that in an inflationary period when construction costs are rising and when the values of existing properties are still going up, foreclosures do not occur in any quantity. Even a 100% loan becomes safe if inflationary pressures increase values faster than depreciation decreases the value of the property. This chart also shows residential rents, general commodity prices, and wholesale building material prices. It will be noticed that building material prices have consistently throughout the entire period gained on commodity prices, and at the present time are rising. The fact that building material prices have risen faster than general commodity prices is another indication that greater efficiency has developed in the production of general commodities than we have developed up to the present time in the production of building materials.

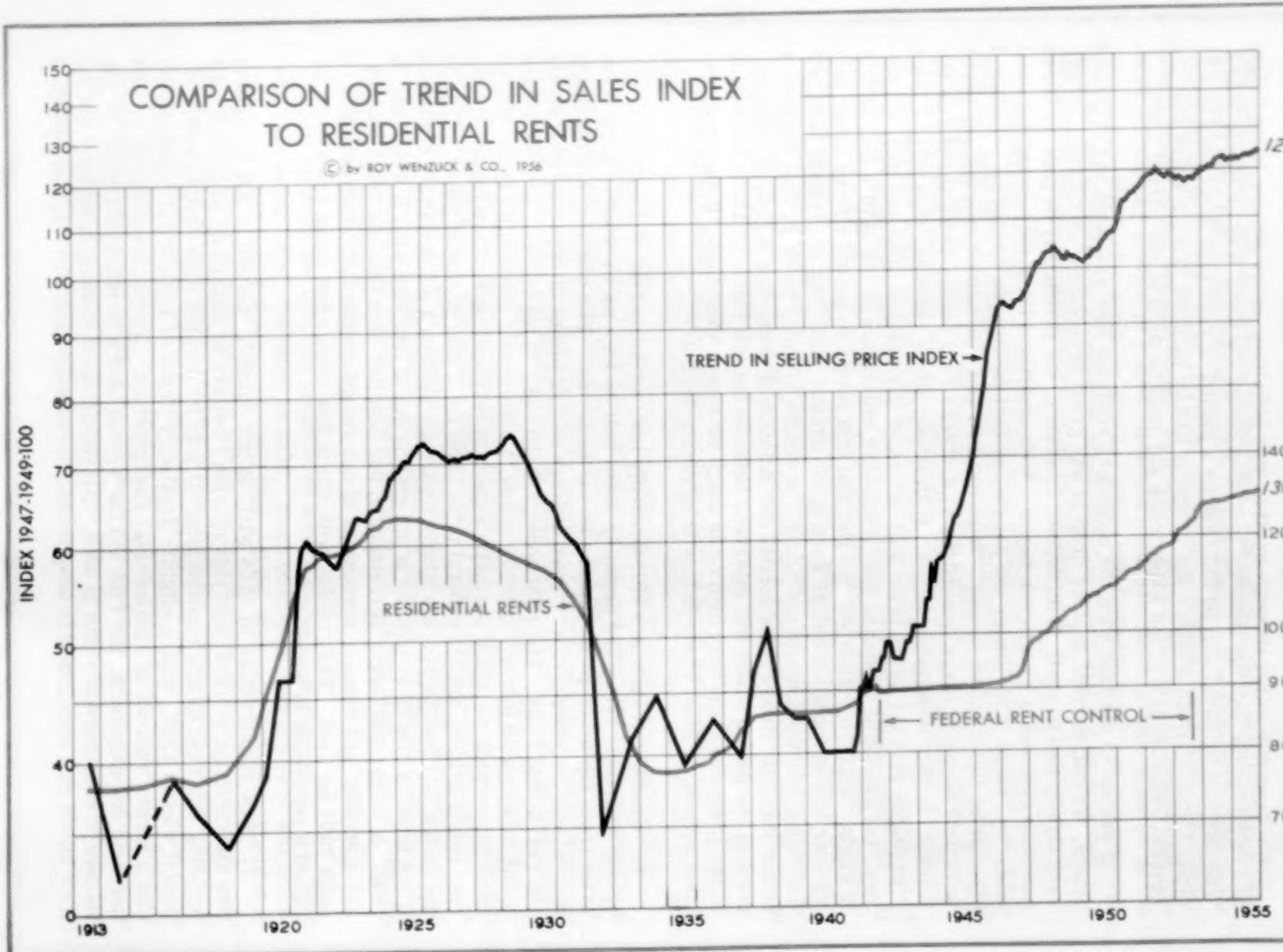
Only twice in the last 100 years have foreclosures gone very high. One peak was reached in 1878, the other in 1932. Each of these peaks followed war inflation - the 1878 peak following the Civil War and the 1932 peak following World War I. These foreclosure peaks were due to the fact that the general price level rose steadily for a long period of years and stayed up for a long enough period for real estate indebtedness to become accustomed to the new level. Then, when the price level dropped, building costs fell, and as the cost of building a new building dropped, the values of all existing buildings dropped by a larger percentage. This left much improved real estate worth less than the mortgage indebtedness, and brought on heavy foreclosures.

We have now come through another war inflation, more severe in its height and in its length than the inflation following either the Civil War or World War I. Whether this inflation will be followed by a period of very high foreclosures will depend primarily on whether the economy can be handled in such a way that the general price level will not experience any radical drop in the period ahead.

It seems to me that with the monetary controls now available in the United States, we can prevent a price drop of any great proportion. We are no longer very tightly tied to gold. With deposit insurance, the probability of runs on banks has been reduced to a negligible factor. With amortized loans not coming due until maturity, there is no longer the possibility that mortgages cannot be refinanced because of tightness of money. With insured and guaranteed mortgages, there is little chance of large quantities of distress real estate being thrown on the market, further depressing values. With strong unions resisting wage cuts, I think it probable that the price level will not show any sizable drop and that, therefore, the chance of repeating the foreclosure experience of the 1870's and 1930's is slight. Possibly, however, the fact that this seems so should also be taken as a warning that economists before each of the drastic reactions in the past have felt that these reactions would not occur. It seems to me, however, that we have a better than fair chance if we control our inflation of preventing a radical readjustment in the period which will intervene between the low rates of family formation of the present and the very high rates which we expect after 1965. If any readjustment comes, it must come in this intervening period.

6. Residential rents are still unusually low, as pointed out in a number of our recent bulletins. They are probably about half as high as we would expect them to be from the other price factors in our economy. The chart on the following page shows the comparison between average selling prices of improved real estate and residential rents. The relationships of the past, in my opinion, will not return in the foreseeable future. In other words, I believe that residential rents will be much below what we would normally expect in relationship to construction costs, real estate prices, and the general price level for a long period of years. This is due to the fact that the average family apparently prefers a single-family residence if the monthly cost of ownership is not greatly out of line with what it would pay in rent. A larger and larger percentage of our families have become home owners, and a smaller and smaller percentage of our recent residential construction is of units built for rent. The rapidity with which this change has come can almost be called a revolution in housing.

7. New construction in 1956 will, in my opinion, exceed in dollar volume new construction in 1955, and this opinion I believe is shared by practically all building and real estate economists. It will be divided differently, however, than it was in 1955, with a slightly smaller volume of residential construction and a larger volume of commercial construction. Through easing terms and lowering downpayments, the FHA and the VA can have a considerable effect on the volume of construction which is done. All Government housing agencies have let it be known that they intend to keep residential construction above 1,200,000 units


COMPARISON OF TREND IN SALES INDEX
TO RESIDENTIAL RENTS
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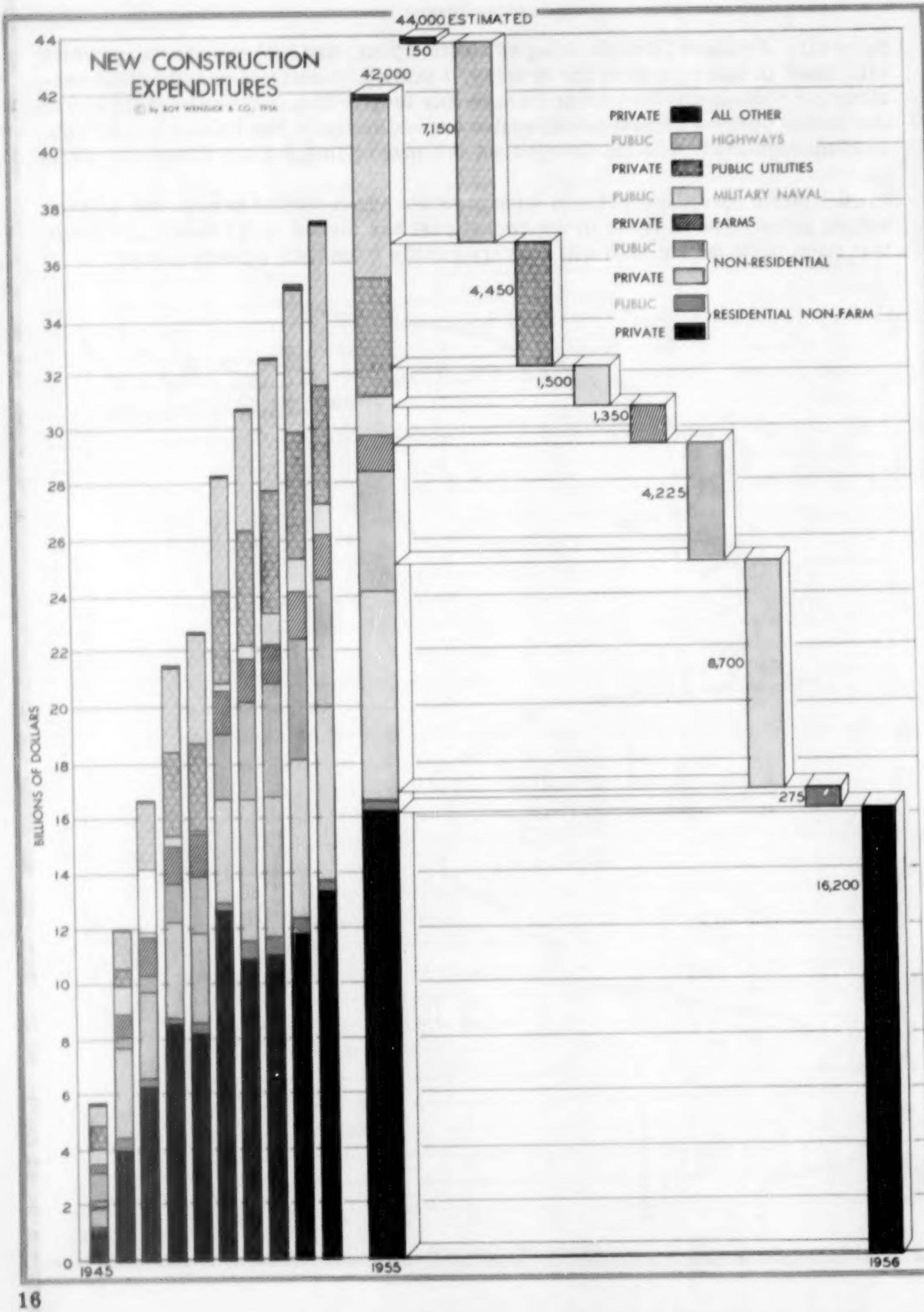
INDEX 1947-1949:100
150
140
130
120
110
100
90
80
70
60
50
40
0
1913
1920
1925
1930
1935
1940
1945
1950
1955
TREND IN SELLING PRICE INDEX
RESIDENTIAL RENTS
FEDERAL RENT CONTROL
124.6
130.8
140
120
100
90
80
70

per year. Nineteen fifty-six being an election year, and with the shortages which still exist in some parts of the country, I think it is entirely possible that construction volume can be held at least to this level. The chart on page 16 shows the dollar volume of new construction expenditures in the United States from 1945 through 1955, with the Government estimate of construction volume for 1956.

8. While the selling price of farm products has continued to slip, the average selling price of farm lands in the recent past has turned up. I think it probable that farm lands during 1956 will not vary greatly from their present prices.

ROY WENZLICK


NEW CONSTRUCTION
EXPENDITURES
44,000 ESTIMATED
42,000
150
7,150
4,450
1,500
1,350
4,225
8,700
275
16,200
PRIVATE ALL OTHER
PUBLIC HIGHWAYS
PRIVATE PUBLIC UTILITIES
PUBLIC MILITARY NAVAL
PRIVATE FARMS
PUBLIC
PRIVATE
NON-RESIDENTIAL
PUBLIC
PRIVATE
RESIDENTIAL NON-FARM
BILLIONS OF DOLLARS
1945
1955
1956